2006/2007 : Report 12

OFFICE OF THE

Auditor General of British Columbia

Switching Tracks:

A Review of the BC Rail Investment Partnership

March 2007

2006/2007 : Report 12

OFFICE OF THE

Auditor General of British Columbia

Switching Tracks:

A Review of the BC Rail Investment Partnership

March 2007

National Library of Canada Cataloguing in Publication Data
British Columbia. Office of the Auditor General.
Switching tracks : a review of the BC Rail Investment Partnership

(Report ; 2006/2007: 12)

ISBN 978-0-7726-5728-2

1. British Columbia Railway Company. 2. BC Rail Investment Partnership. 3. Railroads - British Columbia. 4. Public-private sector cooperation - British Columbia. I. Title. II. Series: British Columbia. Office of the Auditor General. Report ; 2006/2007: 12.

HE2810.B7B74 2007 354.76'7243909711 C2007-960073-5

OFFICE OF THE
Auditor General
of British Columbia

LOCATION:
8 Bastion Square
Victoria, British Columbia
V8V 1X4

OFFICE HOURS:
Monday to Friday
8:30 a.m. - 4:30 p.m.

TELEPHONE:
250 387-6803
Toll free through Enquiry BC at: 1 800 663-7867
In Vancouver dial 660-2421

FAX: 250 387-1230

E-MAIL: bcauditor@bcauditor.com

WEBSITE:
This report and others are available at our Website, which also contains further information about the Office: www.bcauditor.com

REPRODUCING:
Information presented here is the intellectual property of the Auditor General of British Columbia and is copyright protected in right of the Crown. We invite readers to reproduce any material, asking only that they credit our Office with authorship when any information, results or recommendations are used.

2007-04813/

OFFICE OF THE
Auditor General of British Columbia

8 Bastion Square
Victoria, British Columbia
Canada V8V 1X4
Telephone: 250 387-6803
Facsimile: 250 387-1230
Website: http://bcauditor.com

The Honourable Bill Barisoff
Speaker of the Legislative Assembly
Province of British Columbia
Parliament Buildings
Victoria, British Columbia
V8V 1X4

Dear Sir:

I have the honour to transmit herewith to the Legislative Assembly of British Columbia my 2006/2007 Report 12: Switching Tracks: A Review of the BC Rail Investment Partnership.

Arn Van Iersel, CGA
Auditor General (Acting)

Victoria, British Columbia
March 2007

copy: Mr. E. George MacMinn, Q.C.
Clerk of the Legislative Assembly

Table of Contents

Acting Auditor General's Comments 1

Executive Summary 3

Detailed Report 9

- Background 11
  - An Introduction to British Columbia Railway Company 11
  - The BC Rail Investment Partnership 12
  - Federal Involvement in Finalizing the Deal 13
- What are CN's commitments under the Investment Partnership? 17
- Who is monitoring CN's performance in fulfilling its commitments? 21
- What remedies are available to stakeholders and the Province should CN fail to meet its commitments? 25
- Is CN succeeding in fulfilling its commitments to the Province and stakeholders? 29

Appendices

- A CN's Commitments under the Transaction, Revitalization and Consent Agreements 37
- B Why CN was selected by government 45
- C Office of the Auditor General: 2006/07 Reports Issued to Date 47

Acting Auditor General's Comments

Arn van Iersel, CGA
Acting Auditor General

I am pleased to present the findings of my Office's review of the BC Rail Investment Partnership.

The creation of this Investment Partnership brought an end to over 75 years of government-owned railway service in British Columbia, through the sale of all of British Columbia's railway operations and through the long-term lease of all but 37 kilometres of the Province's railway line to the new operator, Canadian National Railway Company ("CN").

The consideration received by the Province included a number of commitments aimed at providing northern communities with economic development opportunities, as well as commitments relating to improved railway service, including transit time, rail car supply and rates.

This review sought to clarify the roles and responsibilities of those agencies overseeing operations under the Investment Partnership and to determine whether performance, in regards to the commitments, is being adequately monitored. We also sought to determine whether the commitments are in fact being met at this time.

We concluded that, in general, there is adequate monitoring of performance. In addition to the federal regulation that applies to all inter-provincial railway operations, certain commitments are being actively monitored by federal agencies for at least the first five years. The British Columbia Railway Company ("BCRC"), which owned the railway operation, still exists and is monitoring those commitments that do not fall under federal jurisdiction.

Our review did not include an examination of the activities of CN. Information received from BCRC, however, along with the fact that, to the best of our knowledge, no complaints have been received by any federal agency suggests that, to date, CN is fulfilling its commitments under the Investment Partnership.

Acting Auditor General's Comments

I would like to thank all of the individuals and agencies that assisted and cooperated with our Office in gathering the information for this review. I would also like to acknowledge the hard work and professionalism of my Office staff who participated in producing this report.

Arn van Iersel, CGA
Acting Auditor General

Victoria, British Columbia
March 2007

❖ ❖ ❖

Review Team

Russ Jones

Jamie Orr

Chris Newton

Jagdip Mann

Chris Rolfe

Bilal Kathrada

Prior to the BC Rail Investment Partnership, the British Columbia Railway Company ("BCRC") owned Canada's third largest railway. The Province acquired ownership of the railway in 1918, initially completing construction of the original line between Squamish and Prince George and later expanding the railway to North Vancouver, Robert's Bank and into northern British Columbia. These operations were considered essential for the export of the province's resource products.

In 1978, the structure of the railway was changed, following recommendations from a Royal Commission, to operate on a commercial mandate rather than one of public policy and economic development. A financial restructuring followed in 1984, with the railway coming under the ownership of BCRC. The Province is the sole shareholder of BCRC.

The actual rail operations were carried on by BC Rail Ltd. and the BC Rail Partnership (not related to the BC Rail Investment Partnership). 100% of the shares of BC Rail Ltd. and of the BC Rail Partnership units were owned by BCRC and its wholly-owned subsidiaries. For convenience, these entities are collectively referred to in this report as BC Rail.

Although BC Rail grossed annual freight revenues of just under $300 million, by 2002 its debt to the Province had reached approximately $500 million. As a result of its Core Services Review and consultations with industry stakeholders, the Province decided to exit the railway industry and subsequently entered into a partnership with Canadian National Railway Company ("CN") where CN would take over the operations of BC Rail.

The BC Rail Investment Partnership ("the Partnership") was a complex transaction consisting of two key components: the Transaction Agreement, setting out the terms of the sale of BC Rail and most of its assets, other than the right-of-way and railbed assets (or "railway line"); and the Revitalization Agreement, which leased these excluded assets to CN. In exchange, BCRC received $1 billion and numerous commitments from CN related to improving services and maintaining competition on BCRC's railway line, and providing growth opportunities and community benefits along that line. The transaction did not include BCRC's 37-kilometre railway line connecting major railways to the Roberts Bank port terminal.

Executive Summary

Purpose of our Review

There has been significant public interest regarding CN's operations on BCRC's railway line since the completion of the Partnership. Although much of the interest relates to several derailments which occurred since CN took over, the underlying question has been in regard to government's level of regulatory oversight over CN's operations on BCRC's railway line.

In this review of the Partnership we seek to clarify the roles and responsibilities of the Province, BCRC, and federal agencies in overseeing CN's operations on BCRC's railway line. Although we recognize its importance, we did not examine or assess the issue of derailments on BCRC's railway line as this falls under federal jurisdiction and is the responsibility of the Transportation Safety Board of Canada and Transport Canada.

The second purpose of our review was to assess whether an adequate process is in place to adequately monitor the performance of CN regarding its commitments under the BC Rail Investment Partnership. More specifically, we wanted to know:

- what are the commitments of CN to the Province and stakeholders under the Partnership;
- who is monitoring CN to ensure its commitments to the Province and stakeholders are fulfilled;
- what remedies are available to the Province and stakeholders should CN fail to meet its commitments; and
- is CN fulfilling its commitments to the Province and stakeholders?

Our review was carried out between November 2005 and November 2006. We focused on the commitments made by CN in the agreements that form the BC Rail Investment Partnership and on the processes to monitor CN's performance in meeting these. The process to select a partner and to attribute a financial value to BC Rail for its sale was evaluated and assessed by an independent consulting firm contracted by the Province, and is not included within the scope of our review. Nor did we directly examine CN's performance under the Partnership or its operations over BCRC's railway line.

Executive Summary

This review was performed in accordance with the assurance standards recommended by the Canadian Institute of Chartered Accountants, and included such tests and other procedures as we considered necessary in the circumstances.

Overall Conclusion

We concluded that a generally adequate system is in place to monitor CN's delivery on its commitments under the BC Rail Investment Partnership. We make one recommendation relating to the monitoring of the Consent Agreement, that BCRC should request a copy of any notice of non-compliance (with the agreement) that may be issued by the Competition Bureau, to CN.

Key Findings

BCRC and federal agencies monitor CN's delivery of its commitments

When CN, an inter-provincial railway operator, was selected to assume the operations of BC Rail, the former BC Rail operations automatically came under federal jurisdiction. Accordingly, the Province effectively transferred most of its oversight responsibilities to federal agencies, and ceased to be a regulator of rail transportation as well as ceasing to be a provider of rail services. Although this was not an objective of the of the Province, once it was clear that the railway would be subject to federal regulation, much of the regulatory and oversight burden was shifted to the federal system.

Various ongoing performance commitments were required by BCRC and the Competition Bureau ("the Bureau") to improve services and rates on the leased railway line and to maintain competition between competing carriers within the province. The Bureau has overall responsibility for overseeing how well CN meets these commitments. The Canadian Transportation Agency ("the Agency") assists by actively monitoring CN's transit times on the leased railway line against benchmarks set by the Bureau. All remaining performance commitments of CN are monitored by the Bureau or Agency through their complaints-driven processes. In these processes, the onus is on stakeholders to forward any complaints regarding CN's performance to the Bureau or Agency. Stakeholders include shippers, communities served by

the railway and competing carriers. During consultations prior to the implementation of the Partnership, BCRC and the Bureau provided information to these stakeholders regarding the complaint process. In addition, both the Bureau and the Agency provide easily accessible information about their complaint processes on their websites.

BCRC is responsible for ensuring that CN has fulfilled its one-time requirements relating to the sale of BC Rail as well as its one-time commitments intended to improve services on the railway line and to achieve the community and economic objectives of the Partnership. We note that most of these commitments have either been met or work is underway. BCRC has verified much of this work through observation or inspection, as well as through representations from CN.

As landlord, BCRC is also responsible for monitoring CN's environmental performance in maintaining the leased railway line.

Various remedies are available should CN fail to meet its commitments

We found various remedies are available under the agreements defining the Partnership and through the federal agencies, should CN fail to meet its commitments. The remedies include:

- a prescribed dispute resolution processes directly between connecting carriers and CN;
- financial penalties against CN for failures to perform to stated transit time benchmarks or fulfill its guarantees to shippers for ordered cars;
- rulings, arbitration, or mediation for any complaints taken by industry stakeholders to the Canadian Transportation Agency; and
- targeted inspections, negotiated settlements, or prosecution for any complaints taken by industry stakeholders to the Bureau.

Should these remedies prove insufficient, and should CN continue not to meet its commitments, further remedies are available to BCRC through its lease of the railway line to CN, that is, through the Revitalization Agreement, including terminating the lease and re-letting the railway line to another railway operator.

Termination, however, would be an onerous process and would be sought only in the case of a significant, sustained and flagrant breach.

We noted that while the Bureau has responsibility for monitoring CN's performance under the Consent Agreement, which incorporates the significant performance commitments made by CN to BCRC, there is no requirement for the Bureau to report any non-compliance on the part of CN to BCRC. The only provision in the agreements for BCRC to learn of non-compliance with the terms of Consent Agreement is a requirement for CN to advise BCRC of any notice of non-compliance received from the Bureau.

It should be noted that CN's main commitments are on public record, and also that the shipping community, who would initiate most remedial actions, would very likely know of any non-compliance in advance of either BCRC or the Bureau. Nonetheless, there are some remedies available only to BCRC, and BCRC should be made aware of any case where CN is not meeting its commitments.

In this report we recommend:

that BCRC, as a signatory to the Consent Agreement, request that the Competition Bureau provide BCRC with a copy of any notice of non-compliance at the time the notice is given to CN.

CN appears to be fulfilling its commitment under the Investment Partnership

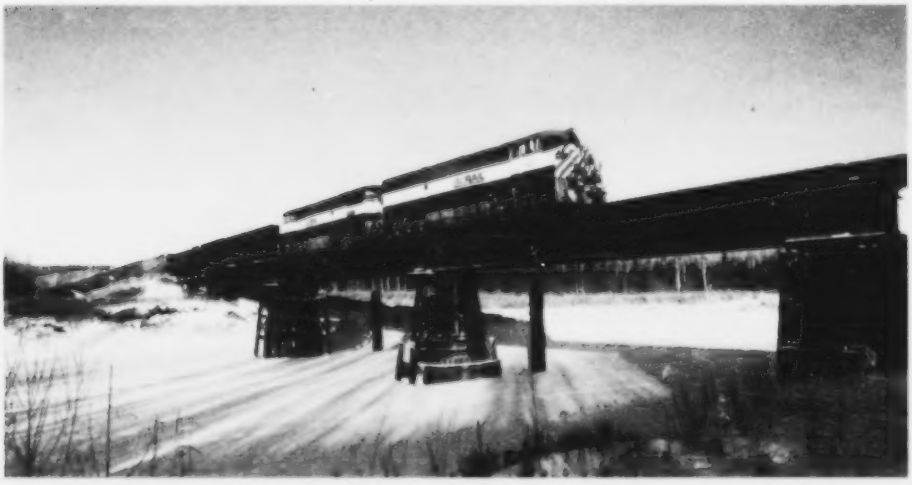
Through observation, due diligence and the representations of CN, BCRC is satisfied that most of CN's one-time commitments have been fulfilled or are in the process of being fulfilled. BCRC will continue to monitor those one-time commitments that are not yet completed. BCRC is also responsible for monitoring CN's performance in maintaining the leased property according to environmental laws and the environmental protocol, however it is too early to make any assessment of performance in this area as the protocol and BCRC's inspection program under the protocol were only established in December 2005.

Based on transit times reports provided by the Agency, CN has met or exceeded the benchmarks for three-of-the-five rate zones. Where CN has failed to achieve the benchmark times it has

remitted penalty payments as required by the Consent Agreement. The amount remitted as at February 28, 2007 was over half a million dollars. This has been placed in a trust fund and will be used to improve reliability and transit times on the railway line through upgrades to the railway line. These upgrades are in addition to any work for which CN is responsible under the Investment Partnership.

The remaining performance commitments are monitored on a complaints-driven process, therefore CN's delivery on those commitments can only be measured based on whether complaints have been received by BCRC, the Bureau or the Agency. At the time of this report, BCRC has not received any notices of non-compliance from CN, and we understand that neither the Competition Bureau nor the Canadian Transportation Agency have received any formal complaints regarding CN's operations on BCRC's railway line. This suggests that, to date, CN is fulfilling its commitments under the Partnership.

We wish to thank representatives from BCRC, the Province, the Competition Bureau, the Canadian Transportation Agency and Transport Canada for their assistance in completing this review.



Source: BCRC

Detailed Report

An Introduction to British Columbia Railway Company

British Columbia Railway Company ("BCRC") is a Crown corporation of the Province of British Columbia, incorporated under the *British Columbia Railway Act*. BCRC's initial mandate was to construct and operate a freight railway in British Columbia. It later expanded its operations to include holding non-rail related real estate, managing a port facility in North Vancouver, and providing itself with insurance coverage.

BCRC's industrial freight railway carried BC products from northern regions to *connecting carriers* in Prince George and Vancouver for transport outside the province. A subsidiary, BC Rail Ltd., and the BC Rail Partnership (not related to the BC Rail Investment Partnership) conducted these operations over a rail network of 2,315 route-kilometres and another 740 kilometres of industrial, yard and track sidings (see Exhibit 1). BCRC or its subsidiary companies owned 100% of the BC Rail Ltd. shares and the BC Rail Partnership units. For convenience these are collectively referred to as BC Rail in this report.

connecting carrier – any competing rail carrier with whom traffic is interchanged, or transferred, with the initial carrier, i.e., BC Rail.

Exhibit 1: The railway network in British Columbia.

Source: BCRC Three Year Service Plan 2003 - 2005

Background

The BC Rail Investment Partnership

In 2002, the Province consulted with shippers, railway community representatives and other stakeholders. These consultations identified concerns about BC Rail, including declining services, lack of available and reliable railcars, uncompetitive freight rates and declining economic opportunities. As a result, the provincial government launched a process to establish the BC Rail Investment Partnership ("the Partnership"). The purpose of this was to stem the increase in the railway's mounting debt to the Province resulting from the need for ongoing capital investment in the rail infrastructure, and to find an experienced partner to operate the railway in a manner that would provide the Province and industry with:

- a sustainable transportation infrastructure that would support the economic development of communities in the province;
- competitive rail freight rates and services that would allow shippers continued access to competing carriers; and
- opportunities for passenger rail services and benefits to various communities in the province through provision of new or continued services on the BC Rail line.

Although the railway operations of BCRC were to be transferred as part of the Partnership, the Province decided to retain, through BCRC, its ownership of the right-of-way and railbed assets, including track infrastructure (referred to as BCRC's railway line). This recognized that the lands underlying the railway line would have continuing value to the Province, should service on the line be discontinued by the operator. Ownership also gave the Province a degree of influence over the operator's management of any environmental issues affecting the underlying lands. As a result, the Partnership would consist of two main transactions: the sale of BCRC's railway operations; and the lease of the railway line to the new operator.

An Evaluation Committee was established by the Province to review proposals from interested parties, obtaining input throughout the process from shippers, mayors of northern communities, and independent advisors with knowledge of the railway industry. On November 25, 2003, following the

recommendation of the Evaluation Committee, the Province, through BCRC, entered into BC Rail Investment Partnership with the Canadian National Railway Company ("CN"). Appendix B presents the Province's announcement of the benefits expected from the selection of CN.

As noted, the BC Rail Investment Partnership involved two key components:

The Transaction Agreement sets out the terms of the sale by BCRC and its subsidiaries of all shares and partnership interests in the railway operating entities, BC Rail Ltd. and the BC Rail Partnership (referred to in this report as BC Rail, collectively).

The Revitalization Agreement establishes a long-term commercial relationship through the lease by BCRC of the railway line to CN for the exclusive purpose of operating the railway. The Revitalization Agreement has an initial term of 60 years, however if all renewal options are exercised, the total term of the agreement will be extended to 990 years.

In consideration, CN paid BCRC $1 billion and made a number of commitments including service, car supply and rates, among others. These commitments are contained within the two agreements.

Prior to above sale and lease transactions, certain non-railway assets were transferred out of BC Rail Ltd. and BC Rail Partnership so that ownership of these assets and operations would be retained by the Province. These assets included subsidiary companies, surplus properties and certain trade marks and trade names not being transferred to CN.

Federal Involvement in Finalizing the Deal

Although it was not an objective of government, it was recognized from the outset that the successful proponent was likely to be a federally regulated railway operator. Under Canada's constitutional framework, both federal and provincial governments have powers to make laws and regulations over rail transportation. When the railway works or undertakings are fully situated within one province and are not for the general advantage of Canada, then those powers are conferred on the provincial government.

Background

Federal Agencies with Oversight Responsibility

The Competition Bureau is an independent law enforcement agency whose role is to promote and maintain fair competition. Headed by the Commissioner of Competition, the organization investigates anti-competitive practices and promotes compliance with the laws under its jurisdiction.

The Competition Tribunal hears applications made under Parts VII.1 and VIII of the *Competition Act*. The Tribunal is a strictly adjudicative body that operates independently of any government department. It differs from the Competition Bureau in that the Bureau investigates complaints and decides whether to proceed with the filing of an application under the Act to the Tribunal.

The Canadian Transportation Agency is an independent, quasi-judicial tribunal that makes decisions on a wide range of economic matters involving federally-regulated modes of transportation (air, rail and marine), and has the powers, rights and privileges of a superior court to exercise its authority. The Agency works to facilitate accessible transportation, and serves as a dispute resolution authority over certain transportation rate and service complaints.

Transport Canada is responsible for setting policies, regulations and standards to protect the safety, security and efficiency of Canada's transportation systems.

The Transportation Safety Board of Canada is an independent agency responsible for advancing transportation safety through the investigation of occurrences in the marine, pipeline, rail and air modes of transportation.

This was the case with BC Rail: operations did not extend beyond the limits of the province, therefore BC Rail was subject to provincial regulation.

When CN was selected, the fact that it was an interprovincial operator meant that it was already subject to federal regulation and that the Province would not have to maintain the same level of oversight as it did when BC Rail was the operator.

The Province also recognized that any transfer of BC Rail's operations to another railway operator would be subject to the approval of Canada's *Competition Bureau* ("the Bureau"). The size of the transaction required that it be filed with the Bureau, and a review was considered likely due to the size of BC Rail and CN's railway operations and the potential for anti-competitive behaviour resulting from CN's exclusive right to operate over BCRC's railway line. A possible concern was the risk that CN might shift *interline rail traffic* from connecting carriers in Vancouver to its own north-south line running from Prince George to Vancouver, resulting in higher costs and reduced service for shippers. In anticipation of a review by the Bureau, the Province and CN included specific service commitments within the agreements between themselves that addressed these competition concerns.

interline rail traffic – rail shipments/traffic originating from or terminating within BC, except locally in Vancouver, and interchanged with a connecting carrier.

As anticipated, the Bureau did review the transaction, holding discussions with market participants, shippers on the BC Rail line, competing carriers, other stakeholders, and the *Canadian Transportation Agency* ("the Agency"). The Bureau identified potential competition issues relating to rail interline transportation of commodities and rail transportation of grain from the Peace River. To address these issues, a *Consent Agreement* was signed between the Commissioner of Competition, BCRC and CN and filed with the *Competition Tribunal*. The agreement provided further interpretation of the service and rate commitments found in the Transaction and Revitalization Agreements, including additional commitments for grain transportation and remedies available to the Province and industry stakeholders should CN not meet these commitments.

A Consent Agreement is filed by the Commissioner of Competition with the Competition Tribunal and has the same force and effect as if it were an order of the Tribunal, which has all such powers as vested in a superior court with respect to enforcing its orders.

Given its role as administrator of federal transportation regulation, the Agency was asked by the Bureau to monitor CN's performance against transit time benchmarks set out in the Consent Agreement. The reporting arrangement for this oversight was formalized between the Agency and CN by entering into the Transit Times Oversight Agreement.

With the filing of the Consent Agreement, the BC Rail Investment Partnership was finalized on July 2, 2004, resulting in the former operations of BC Rail becoming federally regulated for the first time under the jurisdiction of the Competition Bureau, the Canadian Transportation Agency, *Transport Canada* and the *Transportation Safety Board of Canada*.

What are CN's commitments under the Investment Partnership?

CN's commitments to the Province and industry stakeholders, under the BC Rail Investment Partnership, are contained within the Transaction, Revitalization, and Consent Agreements. Since CN, a private company, was acquiring exclusive use of BCRC's railway line, these commitments were a key component of the Partnership and were intended to ensure that:

- shippers had continued access to competing carriers and competitive, improved services and rates; and
- the Province had a means to achieve its public policy objectives through the transaction.

CN's commitments were classified by BCRC as either:

- ***one-time commitments*** that were mainly related to achieving the Province's objective of providing northern communities with economic development opportunities; and
- ***performance commitments*** that were mainly related to improvements in service on the BCRC railway line, including *transit times*, car supply, grain transportation and rates.

transit times – in this context, represents the time in transporting goods from release by the shipper to when the goods are transferred in Vancouver to CN's, or another connecting carrier's line, and vice-versa.

CN was required to meet most of its one-time commitments as part of the completion of the sale of BC Rail and its underlying assets. The remaining one-time commitments must be met relatively early in the term of the railway line lease, while the performance commitments are ongoing.

These commitments are contained in several places in the documents making up the Investment Partnership. A number of significant commitments are set out in a schedule to the Transaction Agreement called the "Service Improvement Undertaking", which is also incorporated in both the Revitalization Agreement and the Consent Agreement. This Service Improvement Undertaking includes commitments such as lowering rates for service on the railway line, providing fair service with and continued access to competing carriers, improving transit times and specific requirements for CN to increase its combined centre-beam rail car fleet by 600 cars and to upgrade no less than 1,500 rail cars.

What are CN's commitments?

It also includes commitments regarding economic development opportunities to northern communities, such as:

- establishing a North Division office and modern Wheel Shop in Prince George and transferring wheel producing work from Western Canada to the shop; and
- supporting infrastructure improvements of the Prince Rupert Port Authority by constructing terminal trackage and upgrading rail infrastructure to accommodate double-stack operations to a maximum of $15 million in capital expenditures.

The Revitalization Agreement is the lease agreement between BCRC and CN, as successor to BC Rail. It contains commitments relating to the rail bed corridor and track infrastructure (and related lands) being leased from BCRC. Article 8 of the agreement requires CN to:

- repair and maintain the leased property as required by regulations and to a specified minimum operating standard;
- provide access to any rail operators wishing to provide passenger service on the leased property;
- provide rail shuttle services between D'Arcy, Seton and Lillooet as well as on the Takla extension for the Takla Lake Indian Band;
- provide rail services consistent with the commitments of BCRC to the 2010 Olympic Bid Committee.

Because the Service Improvement Undertaking is part of all three agreements, the commitments contained in the undertaking are subject to the remedy provisions provided in each of the agreements, should CN fail to meet those commitments. Remedies are discussed later in this report.

The Consent Agreement expands on the commitments within the Service Improvement Undertaking. Since there were no specific performance commitments in the Transaction Agreement to alleviate shipper's concerns related to grain transportation from the Peace River, the Consent Agreement also provides additional service and rate commitments solely related to grain transportation for CN to fulfill.

What are CN's commitments?

Where the Service Improvement Undertaking committed CN to...	the Consent Agreement...
lowering rates;	prescribes the rates to be charged on the railway line, and required CN to publish, maintain and annually adjust those rates to support competition through fair access to rail transportation cost information;
improving transit times on BCRC's railway line;	provides measurable benchmarks, based on BC Rail's previous average performance, to assess whether CN is meeting its transit times commitment;
providing fair service and access for shippers to competing carriers;	lists factors that the Bureau would consider in assessing whether CN is discriminating against shippers that use the services of competing carriers, and required CN to allow competing carriers to supplement CN's fleet with their rail cars when there is forecasted shortages in meeting the shippers rail car demand.

Appendix A to this report contains a more complete list of the commitments, with their classification and source, made by CN under the BC Rail Investment Partnership agreements. It also provides the status of many of the one-time commitments.

Who is monitoring CN's performance in fulfilling its commitments?

The lease agreement established a landlord-tenant relationship between BCRC and CN. Federal regulation of the railway, including the Consent Agreement, established additional relationships between BCRC, CN and:

- the Competition Bureau, as the agency responsible for ensuring that CN's exclusive right to operate on BCRC's railway line does not result in anti-competitive behaviour;
- the Canadian Transportation Agency and Transport Canada, as new regulators of CN's operations on BCRC's railway line; and
- various stakeholders, as parties interested in the commitments under the Partnership.

With these many relationships, it is important to understand who is responsible for monitoring CN to ensure that it fulfills its commitments under the Partnership.

Prior to the Partnership, the provincial government had sole jurisdiction to regulate the railway operations of BC Rail, however when an inter-provincial railway operator was selected, the regulatory responsibility was transferred to the federal agencies. This allowed the Province to remove itself from the railway industry as regulator as well as an operator. In addition, when the performance commitments of the Service Improvement Undertaking were incorporated into the Consent Agreement, those commitments were made terms of the Consent Agreement and came under the Bureau's responsibility for monitoring and enforcement.

The Province is still responsible, however, for monitoring CN's performance under the lease terms of the Revitalization Agreement and its compliance with the one-time commitments contained in the Transaction Agreement.

Who is monitoring CN's performance?

BCRC, on instructions from the Province, established a management system for the relationship with CN, focussed mainly on the environmental maintenance of the leased property. In late 2005, BCRC and CN agreed to an *environmental protocol* to be used to guide their activities related to the environmental management of the leased property.

The environmental protocol between BCRC and CN provides clarification of the terms of the Revitalization Agreement. The agreement states that compliance with environmental laws is the responsibility of CN, and that CN will provide evidence of compliance to BCRC, including allowing BCRC to inspect the property and CN's operations on the property. The protocol establishes timelines for both BCRC and CN regarding notice of requests, disclosures and reporting requirements. The protocol also addresses BCRC's inspections of the property, anticipating that BCRC will inspect the entire property once every three years or at intervals over a three-year period, without any limitation in the scope of the inspection. The Revitalization Agreement requires that information gained in these inspections is to be kept confidential, except under specific circumstances. BCRC carried out its first audit, of one third of the track, in 2006.

BCRC and CN also established a working relationship that allowed, and continues to allow, BCRC to monitor CN's delivery of its one-time commitments. In verifying such delivery, BCRC relies on sources of evidence ranging from written representation from CN to physical inspection by BCRC.

BCRC is not required to monitor maintenance of the leased property for compliance with safety and minimum operating standards. Transport Canada is responsible for safety regulation in the rail transportation industry, and for ensuring adequate monitoring and enforcement of its standards.

Active monitoring of CN's performance against transit time commitments is carried out by the Agency. The Transit Times Oversight Agreement formalized a monitoring and reporting relationship between the Agency and CN. The Consent Agreement requires CN to provide transit times reports to the Agency, which compares these against the benchmarks set out in the agreement. CN's reports of transit times are reviewed by the Agency and verified against information provided by competing carriers and other independent bodies regarding those transit times. The monitoring and reporting relationship between the Agency and CN was initially set up for a five-year period, expiring in July 2009,

however the Bureau can extend this term for another five-years if it determines that CN has not met its transit times commitment during that initial period.

As well, should it become necessary, the Bureau has the ability to actively monitor and assess CN's compliance with its other commitments under the agreement, at any time. The agreement also allows the Bureau to audit any of CN's records that are relevant to CN's commitments within the agreement.

Normally, monitoring the delivery of CN's performance commitments, other than transit times, is carried out by the Bureau using a pre-existing, complaint-driven process. As is the case in other federally regulated railways across Canada, shippers and other stakeholders in BC have the responsibility and opportunity to actively monitor the operator and forward any complaints to the Bureau.

For such a process to be effective, stakeholders must be aware of CN's commitments under the Partnership, have sufficient access to information to assess CN's performance against its commitments and have an understanding of the Bureau's complaints resolution process. Through their consultations with shippers, competing carriers and other industry stakeholders, the Bureau and BCRC provided stakeholders with the knowledge required to monitor and report on CN's delivery of its commitments. It is the responsibility of the stakeholders to maintain this knowledge in the future.

Although much of the oversight by the Bureau and Agency relies heavily on shippers or competing railways to monitor CN's operations on BCRC's railway line, this is consistent with regulation of other interprovincial railway lines in Canada. There appears to be a generally adequate system in place between BCRC, the Bureau, the Agency and Transport Canada to monitor CN's performance in fulfilling its commitments under the BC Rail Investment Partnership.

What remedies are available to stakeholders and the Province should CN fail to meet its commitments?

The BC Rail Investment Partnership changed the way in which freight rail service is provided within the province—CN now has the exclusive right to operate on BCRC's railway line. To mitigate the risk of anti-competitive behaviour resulting from this exclusive right, remedies were made available to the Province and industry stakeholders in the agreements forming the Partnership.

The Transaction and Consent Agreements both provide remedies for connecting carriers to initially address their issues directly with CN. In cases of service deficiency by CN, connecting carriers can provide CN with written notice of the deficiency, which CN must resolve within ten working days or a longer period agreed to by both parties. Any disputes between connecting carriers are to be resolved through a process that progressively escalates the issue to senior management of the disputing party and CN. In addition, an arbitrator may be appointed by the Canadian Transportation Agency if the dispute cannot be resolved between the parties.

Remedies are also available to shippers and the BCRC in the form of financial penalties. If CN cannot deliver the cars ordered by shippers under *CN's Guaranteed Car Order Supply Program*, shippers are entitled to receive financial compensation for each car not provided. If CN fails on its commitment to achieve the benchmark transit times, as per the Consent Agreement, it must remit a penalty equal to one percent of BC Rail's Open Gateway Interline net revenues to a trust fund maintained by BCRC. As noted earlier, the money held in this trust fund will be used to fund upgrades of the railbed assets that will improve reliability and transit times on the railway line. The trust fund is not to be used for expenditures that CN would otherwise be required to make for maintenance. As at February 28, 2007, the balance in the trust fund was $561,544.87.

CN's Guaranteed Car Order Supply Program allows customers to anticipate car supply and manage inventory more effectively with CN guaranteeing to deliver cars to customers on an agreed upon day.

What remedies are available to stakeholders?

As operations on BCRC's railway line are now federally regulated, industry stakeholders within the province also have remedies available to them through the Canadian Transportation Agency. Under the authority of the *Canada Transportation Act*, the Agency acts as a dispute resolution authority over transportation rate and service complaints. Complaints received by the Agency are resolved through formal rulings, arbitration or mediation.

Further information on the Canadian Transportation Agency and its rail transportation dispute resolution process, including how to file a complaint, is available on its website: http://www.cta.gc.ca/.

Because the Competition Bureau is largely responsible for monitoring and enforcing CN's delivery on its performance commitments, industry stakeholders also have access to remedies through the Bureau. As stated within the Consent Agreement, remedies are available under the *Competition Act* if CN engages in a pattern of breaches of its commitments. A breach is considered to have occurred if CN fails to fulfill a commitment, and continues to not meet that commitment for sixty days after being notified of the failure by the Bureau. The Bureau would become aware of such failures by investigating complaints received from industry stakeholders. Remedies used by the Bureau range from educational and facilitative tools, such as information bulletins and targeted inspections, to more direct response tools, such as negotiated settlements and prosecution of CN should it engage in non-conforming activities.

Further information on the Competition Bureau and its enforcement and compliance processes, including how to file a complaint, is available on its website: http://www.competitionbureau.gc.ca/.

The Province, through BCRC as landlord of the leased railway line, has additional remedies available through the Revitalization Agreement. These remedies apply when CN is considered to be in default of the agreement, such default being similar to the breach provisions of the Consent Agreement described above. In such an event, BCRC is allowed to receive compensation for any monetary damages resulting from CN's non-performance and to obtain a court order to ensure CN meets the commitment in question. If CN does not comply within 180 days of receiving a final

judgment, BCRC may terminate CN's lease. These remedies are supplemental to the remedies available through the Transaction and Consent Agreements, *Canadian Transportation Act* and *Competition Act* and BCRC can exercise them as it sees fit. It is considered likely, however, that BCRC would turn to these remedies only as a last resort, after other remedies had been exhausted.

It is possible that BCRC could be delayed in exercising its remedies under the Service Improvement Undertaking as BCRC does not directly monitor CN's delivery of its performance commitments. The Consent Agreement, monitored by the Competition Bureau, requires CN to meet its obligations under the Service Improvement Undertaking, however there is no requirement for the Bureau to report any non-compliance to BCRC. As a result, the only formal notification BCRC would receive, would be from CN itself. The Revitalization Agreement requires CN to provide BCRC with the notices of non-compliance received from the federal agencies.

We recommend that BCRC, as a signatory to the Consent Agreement, request that the Competition Bureau provide BCRC with a copy of any notice of non-compliance at the time the notice is given to CN.

Is CN succeeding in fulfilling its commitments to the Province and stakeholders?

At this time, CN has been operating under the BC Rail Investment Partnership, on BCRC's railway line, for over two and a half years. As a result of its monitoring to date, BCRC is satisfied that CN has met or is actively pursuing all of its one-time commitments, including:

- increasing CN's centre-beam car fleet by more than the required 600 cars and upgrading more than the required 1,500 railcars;
- continuing service on the D'Arcy, Seton and Lillooet and the Takla extension rail lines; and
- establishing a North Division office and modern Wheel Shop in Prince George and transferring wheel production and locomotive repair work to Prince George.

In addition, BCRC directly observed that CN was meeting its commitment to provide access to passenger rail service operators on the leased property with the selection of an operator to provide such service between Vancouver and Prince George. This service became operational in 2006.

It is early, however, to assess whether CN is fulfilling its commitment to maintain and use the leased property in compliance with environmental laws, considering that the environmental protocol and inspection program between BCRC and CN was only established in December 2005.

The first audit of one third of the railway line was carried out in 2006. BCRC has stated that it will continue to monitor CN's commitments related to constructing and upgrading infrastructure at the Port of Prince Rupert and providing rail services as required for the 2010 Winter Olympics to ensure that they are fulfilled by CN.

The Canadian Transportation Agency has been actively monitoring CN's performance against the transit times benchmarks set out in the Consent Agreement. For three of the five transit times benchmark zones, CN has met or exceeded the benchmarks. For the two zones where CN has not achieved the benchmark transit times, BCRC has received and deposited penalty payments of over half a million dollars in a trust fund established in accordance with the

requirements of the Consent Agreement. As noted earlier, this fund will be used for upgrades of the railbed assets in order to improve reliability and transit times.

The remaining commitments regarding transit times and efficiencies, car supply and allocation, grain transportation and rates are monitored by the Bureau and Agency through their complaint-driven processes. To date, BCRC has not received any notices of non-compliance from CN, and it is our understanding that neither the Bureau nor the Agency have received any formal complaints concerning CN's operation on BCRC's railway line. The absence of such complaints suggests that, to date, CN is fulfilling its commitments in these regards.

Response to the Auditor General's Report

Response from the Ministry of Transportation

The Ministry of Transportation appreciates the opportunity to provide a formal response to the Office of the Auditor General's report entitled "Switching Tracks: A Review of the BC Rail Investment Partnership".

In the ministry's opinion, the report accurately reflects the roles and responsibilities of the Province, the British Columbia Railway Company (BCRC), and the federal agencies responsible for overseeing the Canadian National Railway Company's (CN) operations under the BC Rail Investment Partnership. The only active role which remains for the Province, through the Crown Corporation BCRC, is that of landlord of the railway right-of-way, railbed and track. Full accountability for railway operations now rests with CN. CN, as a federal railway, is regulated by the Canada Transportation Agency (CTA) as per the Canada Transportation Act.

The ministry is pleased with the Auditor General's overall report conclusion that in general, there is an adequate system in place to monitor CN's delivery on its commitments under the Investment Partnership. In addition, BCRC confirms that all of the commitments that CN made to the Province under the Transaction Agreement have been satisfied to date.

The ministry feels that the key findings highlighted in the report are very positive and confirm that:

- *provincial and federal agencies do actively monitor CN's delivery on its commitments under the Investment Partnership*
- *there are various remedies available should CN fail to meet its commitments, and*
- *CN is fulfilling its commitments to the Province under the Investment Partnership.*

With respect to the one recommendation made by the Auditor General, the ministry offers the following comment:

Recommendation:

That BCRC, as a signatory to the Consent Agreement, request that the Competition Bureau provide BCRC with a copy of any notices of non-compliance at the time the notice is given to CN.

Response from the Ministry of Transportation

Response:

The Province will request that the Competition Bureau provide BCRC with a copy of any notices of non-compliance at the time the notice is given to CN.

The ministry would like to thank the Auditor General for the opportunity to formally respond to his report.

Appendices

Appendix A: CN's Commitments under the Transaction, Revitalization and Consent Agreements.

We have compiled the following list of commitments from our review of the agreements forming the BC Rail Investment Partnership. Only those commitments relating to service, rates, and government's objectives from the Partnership are included. This is not intended to be a complete list of every commitment made by CN.

The source agreement listed for each commitment is where the details of the commitment are found. Note that although virtually all of the Transaction Agreement commitments listed are incorporated by reference in the Revitalization Agreement, the Revitalization Agreement is not given as the source agreement for these as it does not provide details of these commitments.

The current status of the one-time commitments is indicated in that column.

	Commitment Type		Source Agreement			Monitoring Responsibility			
Commitments	**One-time**	**Performance**	**Transaction**	**Revitalization**	**Consent**	**BCRC**	**CB**	**CTA**	**TC**
1.0 Transit times and efficiencies									
1.1 Shorter and more predictable transit times to market (Transaction, Schedule KK-1). CN must at least meet the following benchmarks for transit times (Consent-p.5):		✓	✓		✓			✓	

Zone	Transit time in hours
1- Vancouver-Lillooet	95
2- Exeter-Williams Lake	100
3- Quesnel-Prince George	120
4- MacKenzie-Fort St. John	150
5- Fort Nelson	170

The transit times are calculated from car release to the time the car is interchanged at the Vancouver Gateways and are based on a six-month rolling average.

Appendix A: CN's Commitments

Commitments	Commitment Type		Source Agreement			Monitoring Responsibility			
	One-time	Performance	Transaction	Revitalization	Consent	BCRC	CB	CTA	TC
1.2 Service performance on traffic in the account of connecting carriers will be on par with service provided by CN for its own traffic, whereby movement and exchange of all rail cars is done pursuant to the *Interline Service Agreements* and CN's own traffic is defined per *CN's train service plan* (Transaction, Schedule KK-1, KK-5).		✓	✓					✓	
2.0 Car supply and allocation									
2.1 Increase the combined centre-beam rail car fleet of CN and BC Rail by 600 cars (Transaction, Schedule KK-2). This supports the general principle of improved car supply for customers (Transaction, Schedule KK-1).	Compliance verified by letter from CN.		✓			✓			
2.2 Upgrade no less than 1,500 rail cars (Transaction, Schedule KK-2).	Compliance verified by letter from CN.		✓			✓			
2.3 Supply customers with all their normal car requirements, subject to fair allocation of the available equipment, regardless of the destination territory or interchange carrier (Transaction, Schedule KK-6) (Consent-p.6).		✓	✓		✓		✓		
2.4 Provide connecting carriers with cars to be supplied by CN following the car allocation rules and Guaranteed Car Order process (CN Tariff 9000) (Transaction, Schedule KK-6). Also, implement its Guaranteed Car Order program with all customers located on the BCRC network (Transaction, Schedule KK-6). This supports the general principle of improved car supply for customers (Transaction, Schedule KK-1).		✓	✓				✓		
2.5 In Forest Products sector, implement and maintain a reserve allocation (a pre-established weekly car reserve for regular customer requirements based on historical normal loading and discussion with the customer) (Transaction, Schedule KK-7).		✓	✓				✓		

Appendix A: CN's Commitments

Commitments	Commitment Type		Source Agreement			Monitoring Responsibility			
	One-time	Performance	Transaction	Revitalization	Consent	BCRC	CB	CTA	TC
3.0 Grain transportation									
3.1 For grain movements to Vancouver in covered hopper cars, CN shall: (i) price traffic via shortest post merger rail route regardless of whether CN discontinues route; (ii) maintain published single car rates from all Peace River Area origination points at a level that does not exceed average of published single car rates from CN origination points within the comparable 25 mile rate group on 2 other lines (Edmonton, Melville); and (iii) maintain published single car rates so that the rate from Dawson Creek and Fort St. John be 10% lower than the rate from Rycroft Alberta for similar grain, conditions, distance to destination (Consent-7).		✓			✓		✓		
3.2 For grain movements to Prince Rupert in covered hopper cars from Peace River, CN shall maintain published single car rates so that the rate to Prince Rupert will not exceed the rate to Vancouver on a % basis by more than the % by which the rate exceeded the rate at closing date (Consent-8).		✓			✓		✓		
3.3 For interlined grain movement, rates from BCRC railway line origination exported to the US are subject to the Open Gateway rate matrix (see 4.0 below) (Consent-8).		✓			✓		✓		
3.4 For interlined grain movements within the Fraser Valley in covered hopper cars, the through rate from Dawson Creek to Fraser Valley destinations will not exceed the through rate from Greater Edmonton Area to the same destinations, and the through rate from Fort St. John to Fraser Valley destinations will be set equal to the through rate from Dawson Creek (Consent-8).		✓			✓		✓		

Appendix A: CN's Commitments

Commitments	Commitment Type		Source Agreement			Monitoring Responsibility			
	One-time	Performance	Transaction	Revitalization	Consent	BCRC	CB	CTA	TC
3.5 For interlined grain movements from points on Alberta RailNet (ARN) and RaiLink Mackenzie Northern (RLMN) lines interchanged at Vancouver Gateways for export to Washington, Oregon, or California, and vice-versa movement back to the Fraser Valley, CN shall maintain published single car through rates to destination so that: (i) the rate from an ARN point shall not exceed the rate from Greater Edmonton Area by more than 10%; and (ii) the rate from an RLMN point shall not exceed the rate from Greater Edmonton Area by more than 20% (Consent-p.8).		✓			✓		✓		
3.6 CN shall maintain published multi-car incentives to qualifying facilities in the Peace River Area, at the same level available in the future to qualifying facilities in the Greater Edmonton Area for similar type, conditions, distances (Consent-p.8).		✓			✓		✓		
3.7 CN shall maintain or exceed BCRC's existing pre-merger frequency of switching service with BCOL Grain Shippers with respect to BCOL Grain Shippers of 3 switches per week with additional switching service up to maximum of 5 switches per week when requested and warranted (Consent-p.9).		✓			✓		✓		
3.8 Interlined grain traffic interchanged with connecting carriers at Vancouver shall be governed by service commitments in the Open Gateway Tariffs; thus, subject to agreements between CN and Grain Shippers, CN shall monitor and measure its transit times as provided in criteria 1.1 and be subject to the same penalties. (Consent-p.9).		✓			✓		✓		
3.9 CN shall allocate cars without discrimination as compared to the Benchmark Territory (the zone comprised of CN Trains Run in Alberta) (Consent-p.9).		✓			✓		✓		
3.10 CN shall offer the other party of agreements between them and BCRC the option to extend the term beyond the existing expiry date for a further period of up to 5 years (Consent-p.9).		✓			✓		✓		

Appendix A: CN's Commitments

<table>
<tr><th rowspan="2">Commitments</th><th colspan="2">Commitment Type</th><th colspan="3">Source Agreement</th><th colspan="4">Monitoring Responsibility</th></tr>
<tr><th>One-time</th><th>Performance</th><th>Transaction</th><th>Revitalization</th><th>Consent</th><th>BCRC</th><th>CB</th><th>CTA</th><th>TC</th></tr>
<tr><td colspan="10">4.0 Rates</td></tr>
<tr><td colspan="10">4.1 Implement and maintain an Open Gateway Rate and Service Commitment, the rates as follows (Transaction, Schedule KK-3):

<table>
<tr><th>Zone</th><th colspan="4">Tonnage per car</th></tr>
<tr><th></th><th>To 65.9</th><th>66-84.9</th><th>85-104.9</th><th>105-119.9</th></tr>
<tr><td>N.Vancouver-Squamish</td><td>$693</td><td>$717</td><td>$766</td><td>$815</td></tr>
<tr><td>Lillooet-Exeter-Williams Lake</td><td>$1,227</td><td>$1,504</td><td>$1,772</td><td>$1,905</td></tr>
<tr><td>Prince George-Quesnel</td><td>$1,521</td><td>$1,580</td><td>$1,886</td><td>$2,206</td></tr>
<tr><td>Mackenzie-FSJ-Dawson Creek</td><td>$1,957</td><td>$2,136</td><td>$2,489</td><td>$2,671</td></tr>
<tr><td>Fort Nelson</td><td>$2,716</td><td>$2,896</td><td>$3,267</td><td>n/a</td></tr>
</table>
These tariffs are further defined in the Consent Agreement (Consent-p.4) and are adjusted annually.

The rates are to be published and adjusted per methods stated in the Transaction Agreement and the Consent Agreement (Transaction, Schedule KK-4).

This supports the general principle that shippers retain access to connecting railways at Vancouver at rates that are lower, in aggregate, than actual BC rail rate divisions (Transaction, Schedule KK-1).</td><td></td><td>✓</td><td>✓</td><td></td><td>✓</td><td></td><td>✓</td><td></td><td></td></tr>
</table>

Appendix A: CN's Commitments

Commitments	Commitment Type		Source Agreement			Monitoring Responsibility			
	One-time	Performance	Transaction	Revitalization	Consent	BCRC	CB	CTA	TC
5.0 Government objectives									
5.1 Continue to support promotion by Prince Rupert Port Authority conversion of Fairview Terminal from breakbulk to container operations, more specifically: (i) construct terminal trackage; and (ii) upgrade rail infrastructure as may be required to accommodate double-stack operations; up to a maximum amount of capital expenditures of $15M (Transaction, Schedule KK-1).		✓	✓			✓			
5.2 Establish a modern Wheel Shop in Prince George, transfer wheel producing work performed by 3rd parties on behalf of BCRC, wheel producing work performed on wheels used by CN in Western Canada, and wheel producing work performed by BCRC's unionized labour outside Prince George, to the shop (Transaction, Schedule KK-1, KK-2).	Compliance verified through inspection by BCRC.		✓			✓			
5.3 Transfer some forest product car repair programs and overhauls of High HP locomotives from Western Canada into the BCRC's car and motive power shops in Prince George (Transaction, Schedule KK-2).	Compliance verified through inspection by BCRC.		✓			✓			
5.4 Re-open the Dawson Creek to Hythe rail link between Northern BC and Alberta (Transaction, Schedule KK-2).	Compliance verified through public posting required by Transport Canada.		✓			✓			
5.5 Establish in Prince George CN's BC North Division office (Transaction, Schedule KK-2).	Compliance verified through inspection by BCRC.		✓			✓			
5.6 Comply with all laws that are applicable to CN, its business, the use, condition and occupation of the leased property, all leasehold improvements and CN's property (Revitalization-p.26).		✓		✓		✓	✓	✓	✓
5.7 Comply with all Environmental Laws regarding the use and occupancy of the leased property (Revitalization-p.42).		✓		✓		✓			

Appendix A: CN's Commitments

Commitments	Commitment Type		Source Agreement			Monitoring Responsibility			
	One-time	Performance	Transaction	Revitalization	Consent	BCRC	CB	CTA	TC
5.8 Provide open and non-discriminatory access on commercially reasonable terms to any rail operators who wish to provide rail passenger service on any portion of the leased property (Revitalization-p.28).	BCRC participated in the selection of the first new operator and has observed the train in operation.			✓		✓			
5.9 D'Arcy-Seton-Lillooet and Takla shuttle services continue (Revitalization-p.28).	Compliance verified through inspection by BCRC.			✓		✓			
5.10 Provide rail services consistent with commitments made by BCRC/CN to the 2010 Olympic Bid Committee as set out in Schedule N of the Revitalization Agreement. Apart from the service commitments for the time period of the Games, the following are the commitments up to the Games dates: (i) construction of a temporary trackside platform at McGuire; and (ii) construction/dismantling of a temporary passing track at Function Junction (Revitalization-p.28 and Schedule N-6).	Outstanding.			✓		✓			
5.11 CN is responsible for all repairs and work required to maintain the leased property (Revitalization-29). Maintenance standards are set out in Schedule D of the Revitalization Agreement.		✓		✓					✓
5.12 Maintain and repair for the first 5 years of the lease term the Tumbler Ridge Line, after which the obligation will be with BCRC, although for the entirety of the lease agreement, CN will not be allowed to remove any of the railbed assets on the line (Revitalization-p.30, 31).	Compliance verified by inspection by BCRC. An operating certificate has been obtained by CN and trains are now running on this subdivision.			✓		✓			

Appendix B: Why CN was selected by government

In its November 25, 2003 announcement, the Province stated that CN's proposal best met the evaluation criteria, providing the following benefits:

Sustainability

- Providing the shortest and fastest route to key North American markets for BC Rail customers.
- Strengthening the railway by ensuring competitive connections with U.S. carriers operating in key western U.S. markets.
- Creating a new Prince George-Chicago Express Train for B.C.'s forest products industry, shipping two days faster than BC Rail or any competitors.
- Making a significant new investment to serve customers with the purchase of 600 new centrebeam cars and 1,500 refurbished rail cars.

Competitiveness

- Sharing significant cost-savings from integrated and expanded rail with shippers.
- Ensuring shippers have competitive options through an Open Gateway policy to ensure competitive access to other interline carriers in Vancouver.
- Creating new choices for shippers, including CN's single-line services to key markets and continued competitive access to other railroads at Vancouver at lower average rates than now charged by BC Rail.
- Providing shippers with non-discriminatory traffic routing via competitive railroads at Vancouver at pre-established, public rates and service equal to what CN charges its own traffic.

Growth opportunities

- Making Prince George home to a new B.C. North Division office for transportation, customer service, engineering, mechanical and general management employees.
- Providing new work for the city's BC Rail shops.

Appendix B: Why CN was selected by government

- Using the Prince George office to provide the forest products industry with high levels of service.
- Investing $1 million in a new state-of-the-art system wheel shop in Prince George.
- Relocating CN system freight car and locomotive work to Prince George.
- Leveraging its unique position in the North to take advantage of the strategic position of the Port of Prince Rupert and the Northern Development Corridor.
- Working actively with the Port of Prince Rupert to support a new container terminal.
- Supporting the introduction of new third-party passenger-tourist train tours on BC Rail and CN railway networks.

Community benefits

- Demonstrating a comprehensive plan to minimize the impact of its operational plan on communities, including early retirement, attrition, relocation and retraining opportunities and generous severance.
- Demonstrating a capacity to find innovative opportunities to create new economic development and job opportunities in communities.
- Substantially increasing money for community services by providing $8.3 million in revenues to local governments.
- Demonstrating extensive experience in working with First Nations.
- Supporting the B.C. treaty process and honouring BC Rail's existing agreements and protocols with First Nations.
- Ensuring rail alternatives for a successful 2010 Winter Olympics and successful upgrade of Sea-to-Sky Highway.
- Freeing up new lands for local economic development, community recreation.

Source: British Columbia Backgrounder

Appendix C: Office of the Auditor General: 2006/2007 Reports Issued to Date

Report 1 – April 2006

Strengthening Public Accountability: A Journey on a Road that Never Ends

Report 2 – September 2006

The 2010 Olympic and Paralympic Winter Games: Review of Estimates Related to the Province's Commitments

Report 3 – November 2006

Audit of Treaty Negotiations in British Columbia: An Assessment of the Effectiveness of British Columbia's Management and Administrative Processes

Report 4 – December 2006

Province of British Columbia Audit Committees: Doing the Right Things

Report 5 – December 2006

Audit of Government's Corporate Accounting System: Part 2

Report 6 – December 2006

Monitoring Government's Finance Province of British Columbia

Report 7 – December 2006

Government's Post-secondary Expansion — 25,000 Seats by 2010

Report 8 – December 2006

Changing Course — A New Direction for British Columbia's Coastal Ferry System: A Review of the Transformation of BC Ferries

Appendix C: Office of the Auditor General: 2006/2007 Reports Issued to Date

Report 9 – January 2007

Seeking Best Practices in Financial Reporting: Report on the Province's 2005/06 Public Accounts

Report 10 – February 2007

Follow-up of 2004/2005 Report 2: In Sickness and in Health: Healthy Workplaces for British Columbia's Health Care Workers

Report 11 – March 2007

Infection Control Needs Care and Attention: The Provincial Overview

Report 12 – March 2007

Switching Tracks: A Review of the BC Rail Investment Partnership

This report and others are available on our website at:
http://www.bcauditor.com

OFFICE OF THE
Auditor General
of British Columbia

BACKGROUNDER

REPORT HIGHLIGHTS **March 2007**

SWITCHING TRACKS – A REVIEW OF THE BC RAIL INVESTMENT PARTNERSHIP

A significant amount of British Columbia's producers rely on rail transport to carry their products, which include lumber, coal and grain, to market. Much of these goods are carried by what used to be BC Rail, a railway operation wholly owned by the Province of British Columbia through the British Columbia Railway Company.

In 2004, BC Rail, except for the actual railway line, was acquired by Canadian National Railway Company (CN). Ownership of the railway line was retained by the Province but is leased to CN under an agreement which may be extended to 990 years if all renewal options are exercised.

This represented a major change in regulation as well as ownership of the former BC Rail operations. Previously regulated by the Province, it is now regulated largely by federal government agencies.

Why we did this review

In 2005, there were some initial concerns raised about possible delays in shipping and rail car shortages. Since additional railcars and faster shipping times, along with reduced rates, were some of the expected benefits of the transaction, we decided to investigate and determine whether there were delays, if any such delays constituted a breach of CN's commitments, and what remedies might exist for the affected businesses.

Given the significance of the BC Rail Investment Partnership, we believed it would also be of value to clarify the roles and responsibilities of the various government agencies involved in overseeing the former BC Rail operations. We also sought to answer these questions:

- what are the commitments of CN to the Province and stakeholders under the Partnership,
- who is monitoring CN to ensure its commitments to the Province and stakeholders are fulfilled;
- what remedies are available to the Province and stakeholders should CN fail to meet its commitments; and
- is CN fulfilling its commitments to the Province and stakeholders?

While issues have been raised regarding several derailments on the BC Rail line since CN took over operations, we did not expand the scope of our review to include safety issues as these are now under the jurisdiction of Transport Canada and the Transportation Safety Board of Canada. Neither did we review any environmental concerns as the effective power of the Province to regulate and enforce its regulations is unchanged by the Investment Partnership.

OFFICE OF THE
Auditor General
of British Columbia

NEWS RELEASE

For Immediate Release
March 29, 2007

Auditor General reports on the BC Rail Investment Partnership

VICTORIA – Acting Auditor General, Arn van Iersel, released a report today in which he concludes that, generally, the monitoring of compliance by Canadian National Railway Company (CN) with the terms of the BC Rail Investment Partnership is adequate.

The report, entitled *Switching Tracks – A Review of the BC Rail Investment Partnership*, sets out the results of a review of whether or not the Province, through British Columbia Railway Company (BCRC) or other agencies, is appropriately monitoring CN's actions in relation to its commitments and whether CN has, to date, met its one-time and other commitments under the BC Rail Investment Partnership.

Mr. van Iersel reports that "Since CN operates across Canada, the former BC Rail line is now under federal regulation and the Province's role is therefore much reduced. The Province's primary responsibility for monitoring is in respect of CN's one-time commitments and as landlord of the railway line, however it also has the power to take decisive action should CN default on its most significant commitments." van Iersel expects that the Province would not take such action until all other remedies have been exhausted, but this would be at the Province's discretion.

With the exception of certain obligations relating to the time taken to deliver goods to or from competing carriers, federal regulation is largely a complaints-driven process. This requires a certain degree of sophistication in that stakeholders must be aware of both the railway's obligations and how to make a complaint should the shipper feel those obligations are not being met.

Mr. van Iersel noted "While BC Rail is monitoring CN, there is no provision for BCRC or the Province to receive notification of complaints made to the Competition Bureau, the federal agency responsible for monitoring a significant part of the terms of the Investment Partnership". Therefore, van Iersel recommends that BCRC request that the Competition Bureau provide BCRC with a copy of any notice of non-compliance given to CN.

The Acting Auditor General also states that "It is too early to say whether CN is fulfilling all of its obligations under the Investment Partnership. Based on monitoring carried out by BCRC, and the apparent absence of formal complaints to any federal agencies, however, it appears that CN has met its commitments to date."

- 30 -

2006/07 Report #12 – Switching Tracks – A Review of the BC Rail Investment Partnership

For further information, please contact:
Office of the Auditor General, 8 Bastion Square, Victoria, B.C. V8V 1X4
Tel: 250 387-6803 or Toll free *Enquiry BC* at 1 800 663-7867 (in Vancouver 604 660-2421)
A copy of the full report is available on our website at: http://bcauditor.com